RS650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 8B
February 23, 1990

IN THIS ISSUE:

LDP Retains Government Control 1

Implementation Of Large Retail Store Law To Be Improved 4

Drexel Failure Fails To Faze Japanese 6

Surging Tourism Lifts Japan's Services Deficit .. 7

Indonesian Telecommunications Project Turns Political 9

Notes: Export Controls; Driftnet Fishing 11

LDP Retains Government Control

Japan's ruling Liberal Democratic Party succeeded in maintaining its 35-year domination of Japanese politics by securing a solid majority in the February 18 lower house elections. Defying some doomsayers who had predicted LDP losses that might necessitate formation of a ruling party-opposition party coalition, the Liberal Democrats captured 275 seats; conservative independents who subsequently aligned with the ruling party upped the LDP's official tally to 286 (see Tables 1-3). This figure is well in excess of the minimum 271 seats the party needed to retain control of all committees in the 512-seat House of Representatives (see JEI Report No. 5B, February 2, 1990). The LDP captured approximately 47 percent of the popular vote, reportedly only slightly below the percentage won in July 1986 when the ruling party gained a record 300 lower house seats.

Since the lower house selects the prime minister, the LDP victory assures continuity in government. However, the election returns do not necessarily assure political stability. Although the opposition parties together could

not usurp the ruling party's controlling majority -- some parties, in fact, lost seats -- the Japan Socialist Party was able to increase its representation from 85 seats to 141 seats. This follows the JSP's unprecedented gains in the July 1989 upper house elections, a victory that served to undermine the LDP's controlling majority in that chamber (see JEI Report No. 32A, August 18, 1989). If the JSP can orchestrate a united opposition in the upper house, the ruling party, despite its apparent renewed strength, may be forced to concede to certain opposition party demands to gain passage of key legislation.

Some political analysts interpret the JSP's gains in the February 18 contests as the voting public's signal to the LDP that all is not completely forgiven, that the ruling party warrants only a qualified endorsement. "The votes that went to the Socialist Party are checking votes against the LDP," Yohei Kono, a senior LDP member was quoted as saying. Gerald Curtis, a Columbia University professor, concurred that the elections represented a "vote of confidence that the LDP is the best thing [the Japanese people] can get, given the options they were offered." He also was quoted as saying that "Japanese voters looked at the prospect of an opposition government and said, 'No thanks,' or at least, 'Not yet.'"

Local issues and "pork barrel" politics in general appeared to have a stronger influence on voters' selection of their lower house representatives than national issues, according to several pundits. Specifically, the Recruit Co., Ltd. influence-peddling scandal, which toppled the administration of former Prime Minister Noboru Takeshita and contributed to the ruling party's defeat in the July upper house elections, did not appear to be of as much concern this time to voters. Virtually all of the senior LDP members who in some way were tainted by the scandal -- including Mr. Takeshita, former Finance Minister Kiichi Miyazawa, former LDP secretary general Shintaro Abe, former Prime Minister Yasuhiro Nakasone and former chief cabinet secretary Takao Fujinami, who is under indictment in the affair -- were returned to office. Mr. Nakasone, who faced what was described as one of the toughest races of his 16-term career, declared that the elections "purged" himself and others caught up in the Recruit web. "The general election is the highest judgment of the people . . . so I think the case has been closed," he said.

However, the electorate was not as forgiving when it came to the 3 percent consumption tax, which went into effect last April. Sadanori Yamanaka, who as chairman of the LDP tax committee played a key role in developing the tax, was voted out of office. Three other ruling party members active in the tax reform debate -- Tatsuo Murayama, former finance minister; Takeshi Moda, vice chairman of the LDP tax committee; and Yuji Tsushima, secretary general of the LDP tax committee -- were returned to the Diet but with considerably less support than they had received in the 1986 elections. The ruling party leadership no doubt interpreted these losses as a painful reminder that the electorate expects to see meaningful action on tax reform when the Diet resumes legislative activity, probably in early March.

Despite the charisma of JSP chairwoman Takako Doi and her nationwide campaigning -- which galvanized the female vote to an extent not known in recent Japanese political history -- Japanese voters in the final analysis apparently viewed with considerable apprehension Ms. Doi's inability to forge a consensus within her own party as well as with the other opposition parties on key foreign policy issues (see JEI Report No. 6B, February 9, 1990). When her

Table 1: February 18, 1990 Lower House Election Results

Party	Seats After July 1986 Elections	Seats When Diet Dissolved January 1990	Seats After February 1990 Elections
Liberal Democratic Party	300	295	286
Japan Socialist Party	85	83	141
Komeito	56	55	46
Japan Communist Party	26	27	16
Democratic Socialist Party	26	26	14
United Social Democratic Party	4	4	4
New Liberal Club	6	0	0
Progressive Party	0	1	1
Independents	9	4	4
Total	512	495*	512

*17 seats were vacant at the time of the February 18 elections.

Table 2: Status of Winning Lower House Candidates

Party	Incumbents	Former Office Holders	New	Total
Liberal Democratic Party	228	5	53	286
Japan Socialist Party	65	16	60	141
Komeito	35	0	11	46
Japan Communist Party	10	2	4	16
Democratic Socialist Party	8	3	3	14
United Social Democratic Party	4	0	0	4
Progressive Party	1	0	0	1
Independents	2	0	2	4
Total	353	26	133	512

Table 3: Current Upper House Party Alignment

Party	Seats
Liberal Democratic Party	109
Japan Socialist Party	73
Komeito	20
Japan Communist Party	14
Democratic Socialist Party	10
United Social Democratic Party	0
Progressive Party	0
Rengo	12
Minor Parties	9
Independents	4
Total	251*

*One seat is vacant.

party ousted the LDP from leadership of the upper house last summer, the jubilant JSP leader proclaimed that the "mountain had moved [and would move again during the lower house elections]." Following her party's February 18 performance, however, Ms. Doi was quoted as acknowledging that the "mountain was very heavy."

The strength of the LDP's win would appear to improve Prime Minister Toshiki Kaifu's chances of retaining his post. Speculation was rampant during the campaign that the former education minister, who is a member of a small LDP faction headed by Toshio Komoto, would be forced out of office in favor of Mr. Abe or another party elder (see JEI Report No. 5B, February 2, 1990). Following the elections, however, Mr. Abe confirmed that it was his impression that Mr. Kaifu would continue to lead the ruling party and, therefore, the government. The fact that some incumbent LDP members were defeated by younger ruling party challengers may suggest that voters favor a generational change in LDP leadership. And Mr. Kaifu, 59, projects a youthful image untainted by major faction, "back room" politicking.

Should U.S.-Japan relations take a turn for the worse, however, pressures again may build to replace the current prime minister with Mr. Abe, who is a former foreign minister, or Mr. Miyazawa, who also is experienced in diplomacy. For the moment, Mr. Kaifu no doubt is breathing a sigh of relief and basking in his party's victory.

Barbara Wanner

Implementation Of Large Retail Store Law To Be Improved

As the third round of talks on the Structural Impediments Initiative approaches, Japan's distribution system is surfacing as a top agenda item. U.S. Ambassador to Japan Michael Armacost, addressing a seminar sponsored by Kansai business groups February 8, said that American trade officials during the February 22-23 SII meetings would focus on the Large Retail Store Law, which they view as a barrier to the entrance of foreign-made goods into the Japanese market. Many newspapers reported that he said Tokyo should spare no effort to reform the law, which regulates the opening of major retail operations, or, better yet, abolish it entirely. The ambassador later clarified that he replaced the sentence "abolish it entirely" in his speech with "provide an equal opportunity for American companies." He reportedly made the change in view of the potential impact of his comments on the February 18 lower house elections -- in particular, its possible effect on the Liberal Democratic Party's showing. Whether the U.S. request be to abolish the law or not, the topic is certain to be a central matter of discussion in the upcoming SII talks.

Seemingly responding to the ambassador's remarks, Prime Minister Toshiki Kaifu said February 9 that the government is studying specific measures to ease implementation of the Large Retail Store Law. Mr. Kaifu told reporters that Japan has no plans to revise the law itself; instead, the legislation will be applied more flexibly, mainly by setting a time limit for processing applications by department stores, supermarket operators and discount chains interested in opening new stores. A Ministry of International Trade and Industry advisory group outlined these changes last June (see JEI Report No. 24B, June 23, 1989). Analysts suggest Mr. Kaifu made the commitment to relax implementation

particularly American, M&A deals. Japanese banks anted up more than $2 billion for Campeau Corp.'s ill-fated $6.6 billion purchase of Federated Stores Inc. Japanese banks also have participated heavily in highly visible megadeals, such as the buyout of RJR Nabisco Inc. and the merger between Time Inc. and Warner Communications Inc. The failure of the top junk bond firm is likened to the last nail in the coffin of an era of uninhibited M&A activity. Recent sharp declines in the junk bond market have led American and foreign investors to adopt tougher standards for evaluating M&A deals. While this will make the current M&A market downturn sharper, it may help stabilize the business over the long run.

In the meantime, Japanese firms continue to learn the ropes of the fast-moving and complex M&A market. Beginning in 1986 several Japanese companies forged ties with American M&A specialists: Sumitomo Bank, Ltd. put $500 million into Goldman, Sachs & Co.; Nippon Life Insurance Co. invested $508 million in Shearson Lehman Hutton Inc.; Nomura Securities Co., Ltd. bought a one-fifth stake in Wasserstein, Perella & Co.; Nikko Securities Co., Ltd. purchased a similar share of the Blackstone Group; Yamaichi Securities Co., Ltd. put $25 million into Lodestar Partners; Long-term Credit Bank of Japan, Ltd. has invested in Peers & Co.; and Fuji Bank, Ltd. formed a joint venture with James D. Wolfensohn Inc. Mitsui Bank, Ltd. is the latest to join the M&A parade, announcing in January that it was contributing $25 million to a $250 million fund managed by the Carlyle Group.

These tie-ups have had very uneven results: Sumitomo and Goldman, Sachs are prevented from doing joint business by the Federal Reserve Board, and Nippon Life's investment in Shearson has declined, on paper, by more than $350 million. There also are reports of friction between some of the partners, an unsurprising reaction since some of the Japanese firms are trying to build up independent M&A units. Overall, however, there is agreement that the tie-ups serve the interests of both partners in the short and the long term. Drexel's bankruptcy is a pothole -- not a blackhole -- in Japan's path to a major role in the global M&A market.

Jon Choy

Surging Tourism Lifts Japan's Services Deficit

What country has the world's largest international deficit in travel services? The new champion globe trotter will come as no surprise to Americans, particularly those who have made a recent trip to Hawaii or to other well-known tourist destinations in the United States. In 1989 Japan appeared to have the largest international deficit in travel income, for the first time taking the lead from the West Germans, according to Japanese press reports.

Economists who have studied international travel patterns were not surprised. At least since the advent of flexible exchange rates in the early 1970s, tourism has proved to be one of the international activities most responsive to currency movements. Just as Americans flocked to Europe in the early 1980s in response to a dollar that seemed to buy far more than it had a few years earlier, Japanese tourists have found new reasons since the yen began appreciating in 1985 to hop on a plane at Narita or another Japanese airport

and head overseas. Japan's travel-related deficit in 1989 of $19.3 billion was enough to offset about one-quarter of its trade surplus (see Table). The Japanese took more than 9.6 million trips abroad last year, records show.

Japan's Services Trade, 1985-89

(net balance in millions of dollars, IMF value basis)

	1985	1986	1987	1988	1989*
Travel	$-3,677	$-5,766	$-8,663	$-15,789	$-19,327
Passenger Fares, Freight and Other Transportation	-2,649	-2,537	-6,106	-7,436	-8,320
Investment Income	6,840	9,473	16,670	21,032	23,434
Other	-5,679	-6,102	-7,603	-9,070	-11,712
Total Services	-5,165	-4,932	-5,702	-11,263	-15,925

*Preliminary

Source: Bank of Japan

Besides helping to reduce Japan's overall current account surplus, the increase in foreign travel has had other effects. Following in the footsteps of Americans a generation before them who spawned an empire of Holiday Inns and other American-type facilities abroad, Japanese tourists have created a demand for hotels and other Japanese-oriented amenities in the top tourist destinations. In Hawaii the recent transfer of the local 7-11 convenience stores to Japanese control was said to be, in part, a response to Japanese tourists who found the indigenous stores unlike the "real thing" in Japan. (7-11 stores in Japan, originally an offshoot of the American chain, have evolved independently in recent years, although to the casual American tourist they still appear to be a reasonable facsimile of the U.S. version.)

The surge in tourism has buried, at least for the moment, concern prominent several years ago regarding the services component of Japan's current account. At the time many experts felt that rising interest, dividend and other income from direct and portfolio investment would offset a significant portion of any improvement in the trade balance resulting from the stronger yen. Just as surpluses on overseas investment income masked for a while the deterioration of the U.S. balance of payments in the 1980s, this argument went, the decline in Japan's services deficit -- a result of higher investment income -- would offset any reduction in its trade surplus.

Investment income has, in fact, surged since 1985 as the yen has appreciated. Japanese tourists were not alone in discovering the price advantages of overseas locations; Japanese manufacturers rushed to establish facilities in North America and Asia and elsewhere to maintain their competitiveness. Portfolio investment rose even more. In 1989 the surplus in investment income remained larger than the deficit in travel. However, the deficits in the remaining services accounts also grew, resulting in an increase in the overall services deficit, not the decrease that was widely forecast. The resultant services deficit was the main reason that Japan's current account surplus was 26

percent smaller than the trade surplus in 1989. (For details of the overall 1989 current account, see JEI Report No. 7B, February 16, 1990.) Today, few are willing to state with much confidence whether travel and other trade in services will continue to outpace investment income. However, with even fewer believing that Japanese tourists have had their fill of foreign travel, growing deficits in international travel expenditures virtually are guaranteed.

Douglas Ostrom

Indonesian Telecommunications Project Turns Political

International competition for a big Indonesian telecommunications contract that reportedly has been narrowed to bids from two rivals -- American Telephone and Telegraph Co. and NEC Corp. -- has created a tense political situation for Jakarta. The selection of one firm over the other may bring cries of foul from the loser and dampen the relations of Jakarta and that company's government. On the one side are trade and security relationships with the United States; on the other are foreign aid and investment relationships with Japan. Both are vital to Indonesia.

The Bush administration's reaction to rumors that Tokyo had applied political pressure to gain the contract for NEC has been quick and intense as American officials attempted to show that Washington will stick up for American businesses overseas if they are not treated fairly. The rumors have fueled American concerns that Japan does not "play on a level field" and have sparked calls in Washington for increased competitiveness. Deputy Secretary of State Lawrence Eagleburger said in a November 30, 1989 speech that State will do more to promote U.S. economic interests overseas. He added that Secretary of State James Baker hopes to boost counseling by government officials to help American businesses operate abroad and to promote exports. In advising American companies about the types of assistance they can expect from State, Mr. Eagleburger announced a "Bill of Rights for American Business," in which one provision asserts Americans "have a right to the active promotion of U.S. firms in international bids. . . ."

The Second Digital Telephone System project, part of Indonesia's national development plan, is valued at around $300 million. The company that installs this phase, however, also is expected to be awarded the remainder of an estimated $2 billion telecommunications project. The tenders are for installation of digital central office switching equipment that can handle 350,000 lines.

The field of five foreign competitors reportedly narrowed by February 12 to just two -- AT&T and NEC. The U.S. Embassy in Jakarta reportedly told Washington that Tokyo was trying to influence the outcome of the deal, perhaps through references to Japan's $9.8 billion direct investment position in Indonesia as of March 31, 1989 and its $985 million in foreign aid in 1988 alone. Japan is the top aid donor to Indonesia (see Tables 1-4). To counter the purported influence of Tokyo, President Bush sent a letter February 2 to President Suharto asking Indonesia to consider the AT&T bid, according to the Washington Post. State Department officials, however, would not comment to JEI whether Mr. Bush or Secretary of State James Baker had tried to influence Jakarta's decision.

Table 1: Japanese and U.S. Trade with Indonesia, 1985-89

(in millions of dollars; exports f.o.b./f.a.s., imports c.i.f.)

	Japan			United States		
Year	Exports	Imports	Balance	Exports	Imports	Balance
1985	$2,173	$10,119	$-7,947	$795	$4,933	$-4,138
1986	2,662	7,311	-4,649	946	3,675	-2,730
1987	2,990	8,427	-5,437	767	3,719	-2,952
1988	3,054	9,497	-6,443	1,056	3,494	-2,438
1989	3,301	11,015	-7,714	1,256	3,543	-2,286

Sources: Ministry of Finance and Department of Commerce

Table 2: Japanese and U.S. Official Development Assistance To Indonesia, 1984-88

(in millions of dollars, net disbursement basis)

	1984	1985	1986	1987	1988
Japan	$168	$161	$161	$707	$985
United States	61	43	46	36	22

Sources: Ministry of Foreign Affairs and Agency for International Development

Table 3: Japan's Cumulative Direct Investment in Indonesia, FY 1984-FY 1988

(in millions of dollars, gross announced value)

FY 1984	FY 1985	FY 1986	FY 1987	FY 1988
$8,015	$8,423	$8,673	$9,218	$9,804

Source: Ministry of Finance

Table 4: U.S. Cumulative Direct Investment in Indonesia, 1984-88

(in millions of dollars, net book value)

1984	1985	1986	1987	1988
$4,093	$4,475	$3,217	$3,050	$3,006

Source: Department of Commerce

Officially, neither Washington nor Tokyo concedes having lobbied Jakarta to influence the award of the telecommunications contract. The State Department wants to see the contract awarded on a fair basis, founded on the technical and the financial packages offered, an official noted. An Indonesian Embassy official in Washington similarly asserted that in awarding international contracts ". . . a thorough study of all aspects combined with rational, just and fair consideration have always been the government's primary guidance. . . . We do not allow either economic bias or political pressure to cloud our judgment." No threats of retaliation, such as reduced trade or aid, have been made by either the United States or Japan, various sources implied.

The furor over the telecommunications contract, if reported accurately, has shown the resolve of the United States to support its businesses overseas and its willingness to counter "unfair" advantages taken by foreign governments, be they Japanese or other. The competition comes at a time of broader economic rivalry and generally hostile feelings among those concerned about the causes of the stubborn U.S. trade deficit with Japan. Taking a strong stance may win the president the domestic support he needs to create an agenda to tackle the trade deficit.

Gretchen Green

Notes

Export Controls - Despite the relaxation in East-West tensions and building momentum for political and economic reform throughout the Soviet bloc, the Cocom (Coordinating Committee on Multilateral Export Controls) meeting in Paris February 14-15 found members proceeding with caution in considering the extent to which export controls should be relaxed on sophisticated technologies destined for Eastern European markets. For the past 40 years this 17-nation body has sought to safeguard strategic technology from countries deemed hostile to the Western alliance.

According to U.S. sources, member nations agreed on certain procedural reforms and an "intensified program" for modernizing the Cocom control list. Specifically, Cocom participants agreed to cut the processing of export licenses from a maximum of 12 weeks to 8 weeks. In terms of "modernizing" the Cocom control list, State Department spokesman Richard Boucher said that an agreement was reached on a U.S. proposal to focus liberalization in three product areas: telecommunications equipment, computers and machine tools. No products were struck from the list. "Technical experts will meet to complete [this review] by the end of May," Mr. Boucher stated. "We may identify additional product categories for priority attention later."

This statement would appear to downplay numerous press reports concerning an alleged agreement in principle to allow reformist Eastern European countries the same access level granted China in the aforementioned product categories. In response, a U.S. government source would say only that a number of liberalization approaches are under consideration. In his statement Mr. Boucher noted that Cocom members welcomed overtures from various Soviet bloc countries to protect Western technology but cautioned that favorable treatment is contingent on their adoption of "credible safeguard measures."